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CIA/RR CB 65-7
January 1965

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INTELLIGENCE BRIEF

EGYPTIAN FINANCIAL PROBLEMS

DIRECTORATE OF INTELLIGENCE
Office of Research and Reports

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EGYPTIAN FINANCIAL PROBLEMS

Egypt is caught in a financial dilemma born of progressively growing overcommitment in many fields. The current crisis -- the culmination of a situation that has existed for several years -- is largely the product of a longstanding deficiency of foreign exchange. In his attempts to raise living standards in the United Arab Republic (UAR) and to gain a place of importance on the world scene, Nasser has assumed heavy financial commitments. Industrial investment, welfare services, military power, and foreign ventures have been costly, and these programs have made conflicting demands on inadequate resources. A rate of economic growth of almost 6 percent per year has been attained, an industrial complex has been implanted, and the military forces have been equipped with modern weapons, but these gains have been accomplished at a high cost, particularly in terms of serious depletion of present foreign exchange and the need to employ a significant share of future exports to pay for past imports of military and industrial equipment.

Financial assistance adequate to support Nasser's programs has become increasingly hard to find, and some adjustments in economic policy appear likely. Consumer goods may become more scarce in the months ahead, and the ambitious development program may be subjected to close scrutiny. The unrealistic nature of economic goals is becoming increasingly hard to ignore as financial difficulties mount. Development credits of the sort provided earlier by the Communist countries will neither solve the problems nor have much impact on the short-term symptoms. US deliveries of food under P. L. 480 are more directly applicable to existing problems, covering an important although relatively small part of the many shortages. Private foreign investment is almost at a standstill, largely because of nationalization policies.

1. Shortage of Hard Currency

Sale of more than $30 million of the UAR's official gold holdings -- a sharp departure from past policies -- is clear evidence that other sources of ready money have been exhausted. From the end of World War II until the early 1960's, Egypt financed a growing trade deficit out of large reserves of foreign exchange and foreign assets. Resources were strained further by compensation payments to foreign owners of nationalized companies. Little remained of former holdings in 1961, when a cotton crop failure and expanding development costs doubled the balance-of-payments deficit in a single year.

With reserves exhausted, Egypt turned to the International Monetary Fund (IMF) and private Western banks. During 1962-64, $90 million

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was drawn from the IMF, and short-term commercial credits were amassed. By the end of 1964, however, the limits of these lines of credit apparently were reached. Moreover, repayments on long-term development loans extended in the 1950's also were beginning to mount. The current annual obligation of some $60 million to $70 million on long-term loans now extant is expected to reach about $95 million in 1966 and about $160 million by 1970. Bankers, fearful for the safety of existing short-term loans, have resisted pressures to increase the amounts outstanding. With no place else to turn, the UAR has converted gold from its "currency cover" into the hard currency required to meet overdue commitments. This temporary expedient, however, does little to relieve the continuing pressure.

Hard currency earnings are increasing, but not fast enough to cover the payments deficit. Sketchy data from Egyptian sources indicate that foreign exchange earnings for 1964 may have been somewhat more than $50 million above the level of 1963, with most of the increase probably in hard currency. An increase of this magnitude would be a noteworthy achievement, but in the context of the deficit on current account in 1963 of $283 million (including $132 million in US loans in local currency), earnings remain far from adequate.

2. Shortages of Consumer Goods

A serious shortage of consumer goods that developed in the fall of 1964 brought popular discontent into the open for the first time. Strict import controls were imposed in mid-year, and, in an attempt to keep the industrial complex operating and growing, emphasis was placed on restraining "nonessential" (consumer) imports. Much of the consumer merchandise for urban markets must be imported, and that which is manufactured at home requires a high proportion of imported raw materials and components. While the influx of foreign goods was being curtailed, the government continued to subsidize food prices and to control prices (many below cost) of manufactured items. Within a few months the available supplies of food, clothing, and consumer durables in city stores had dwindled, and potential purchasers, unable to buy goods from government cooperatives, were turning to the black market. Profiteering became widespread, and consumer dissatisfaction mounted.

New measures were adopted to reduce the disparity between supply and demand and to quiet the unusual display of public unrest. An emergency expenditure of $92 million in foreign exchange from budgeted

funds was authorized for the immediate import of goods to satisfy the most urgent consumer needs. Price controls on some locally produced foods were lifted to encourage farmers to increase the supply in domestic markets. Meat rationing was imposed, food marketing channels were reorganized, and the government began a concerted campaign to promote saving and to discourage consumption. In an attempt to siphon off increased consumer purchasing power, a higher interest rate on savings accounts was introduced, accompanied by an official campaign urging workers to increase savings as their way of contributing to economic progress.

3. Difficulties in Industry

Egyptian industry has made tremendous advances and now contributes about one-third of national income, but it is suffering from -- and adding to -- the economic difficulties besetting the country. The iron and steel plant at Helwan, a project justified more by prestige than by potential profitability, is an outstanding example. One of the two blast furnaces was closed down for several months in 1964 because the currency shortage had caused a delay in orders for necessary replacement items. As a result, increased imports of steel are needed to fill the gap. Other factories operating far below capacity for lack of spare parts and raw materials include the Ford and Fiat automobile plants; cement factories; and plants producing plastics, batteries, and paper. Funds to purchase the necessary inputs, which must come from abroad, are not available. In spite of this shortage of foreign exchange, however, a new law has just been drafted that would prohibit any enterprise from closing down, either wholly or partly, without government permission.

4. Bloc Economic Assistance

The Communist countries seem willing to support Nasser's programs by using the traditional solutions of soft currency and the stretching out of debt obligations. They do not appear willing to provide the massive injections of hard currency required to finance the Egyptian trade deficit with non-Communist countries. In mid-December 1964 the UAR's cumulative deficit on bilateral trade accounts (mostly with Communist countries) had reached $232 million -- an increase of about $18 million in 1 month. Bilateral agreements permit the creditor country to demand hard currency payment of debit balances above a certain limit, but in December Soviet officials reportedly promised not to exercise this option, thus removing a potential threat, at least for a time.

New trade agreements with the USSR, several European Satellites, and Communist China provide for higher debt limits. Egyptian ministries have been instructed to divert foreign purchases to Bloc countries, even when Western equipment would be cheaper or better.

The promise of almost half a billion dollars in new economic credits by Communist countries in 1964 should help to make further industrialization possible. However, Egypt needs goods -- especially food and manufactures -- in a quantity that the Bloc may not be willing to provide. To date, no offers of hard currency for such a purpose have been noted.

5. Search for a Solution

Nasser himself has admitted publicly that serious problems exist and will require drastic solutions. Thus far, however, only minor steps have been taken to stem the flow of funds abroad. Selective tax increases and import surcharges were introduced last summer. More recently, government offices abroad have been closed, salaries of officials serving overseas have been withheld in part, and foreign travel has been curtailed.

Responsible officials assert that more basic changes will be adopted. The Minister of the Treasury has projected imports of $828 million for the fiscal year ending 30 June 1965 -- a drop of 13 percent in spite of the emergency expenditure of $92 million. Prime Minister Ali Sabri has admitted that the development effort must be slowed down, and the Minister of Economy has stated that investment in industry has been cut 15 percent below the budgeted level in the current fiscal year and that the cut in the services sector has been set at 30 percent. Nasser has claimed that his people will "tighten their belts" for the sake of national growth, but recent disturbances indicate that the process will be painful politically as well as personally.

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